



April 9, 2009

Mr. Charles Terreni
Chief Clerk/Administrator
South Carolina Public Service Commission
Post Office Drawer 11649
Columbia, South Carolina 29211

Re: Docket No. 2008-251-E

Dear Mr. Terreni:

Enclosed for filing in the above-referenced docket is the Joint Proposed Order of Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc. and the Office of Regulatory Staff.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Len S. Anthony', with a large, stylized loop at the end.

Len S. Anthony
General Counsel
Progress Energy Carolinas

LSA:mhm

cc: John Flitter

Enclosure

STAREG334

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2008-251-E
Order No. 2009-_____

IN RE:)	
Application of Carolina Power and Light)	JOINT PROPOSED ORDER OF THE
Company d/b/a Progress Energy Carolinas,)	OFFICE OF REGULATORY STAFF AND
Incorporated for the Establishment of)	CAROLINA POWER AND LIGHT
Procedures for DSM/EE Programs)	COMPANY, D/B/A PROGRESS ENERGY
		CAROLINAS, INC.

On June 27, 2008, pursuant to S.C. Code Ann. § 58-37-20 (Supp. 2008), and S.C. Code Ann. Regs. 103-819, 103-820 and 103-823 (Supp. 2008), Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc. ("PEC") filed an application with the Public Service Commission of South Carolina ("the Commission") requesting the Commission establish procedures that encourage PEC to invest in cost effective energy efficient technologies and energy conservation programs. PEC also requested the Commission approve the establishment of an annual rider to allow recovery of all costs associated with such programs and the recovery of an appropriate incentive for investing in such programs. Thereafter, the Commission established Docket No. 2008-251-E to consider PEC's Application, required PEC to publish notice of the proceeding, established August 8, 2008 as the deadline for intervention, established testimony prefilng dates and scheduled an evidentiary hearing for December 9, 2008.

The Office of Regulatory Staff (“ORS”) duly gave notice of appearance in this proceeding. Nucor Steel-South Carolina and Wal-Mart Stores East, LP, timely filed petitions to intervene which were allowed.

Upon the joint motion of PEC, ORS, Nucor and Wal-Mart, the Commission revised the testimony filing dates and rescheduled the evidentiary hearing for February 12, 2009.

The Natural Resources Defense Council, the Southern Alliance for Clean Energy, the Coastal Conservation League and the Southern Environmental Law Center (hereinafter collectively referred to as “Environmental Intervenors”) petitioned to intervene out of time and were allowed to do so.

Pursuant to the Commission’s testimony filing date schedule, PEC filed the direct testimony and exhibits of B. Mitchell Williams on January 8, 2009. On January 14, 2009, PEC filed a revised exhibit to Witness Williams’ testimony clarifying the integration of PEC’s initial Application and the exhibit to Witness Williams’ January 8, 2009 testimony to establish a Demand Side Management/Energy Efficiency Cost Recovery Mechanism and Procedure. On January 22, 2009 Wal-Mart filed the direct testimony of Steve W. Chriss, and the Environmental Intervenors filed the direct testimony of Richard Hornby and Brian Henderson.

On January 23, 2009, PEC, Nucor, Wal-Mart, and ORS (“Stipulating Parties”) filed a Stipulation Agreement resolving all issues in this proceeding. The Stipulation Agreement included a DSM/EE cost recovery mechanism and procedure (hereinafter referred to as “the DSM/EE Procedure”) which addressed the recovery of PEC’s DSM/EE costs, the recovery of net lost revenues, a performance incentive to encourage PEC to aggressively pursue DSM/EE programs, and the filing procedures and

requirements for establishment of a rider to allow recovery of PEC's DSM/EE program costs. The DSM/EE Procedure contained in the Stipulation is consistent with PEC's January 14, 2009 filing with limited exceptions that improve the Procedure.

The Stipulating Parties have agreed that the Stipulation is reasonable, in the public interest, and in accordance with law and regulatory policy. The Stipulation provides that the provisions of the Stipulation do not reflect any position asserted by any of the Stipulating Parties, but reflect instead the compromise and settlement among the Stipulating Parties as to all of the issues covered in the Stipulation. The Stipulation provides that the Stipulation is a product of negotiations between the Stipulating Parties and reflects the complete agreement of the Stipulating Parties, and provides that no portion of the Stipulation will be binding on the Stipulating Parties unless the entire Stipulation is accepted by the Commission. If the Commission rejects the Stipulation in whole or in part, the Stipulating Parties reserve the right to withdraw from the Stipulation. If a Stipulating Party exercises its right to withdraw from the Stipulation, the Stipulating Parties shall request that the Commission provide the opportunity for each Stipulating Party to present evidence and advance its position in this proceeding.

The Commission recognizes that the Stipulation is a compromise among diverse parties with varying interests and positions, and that the Stipulation must be evaluated in this context. The Commission also notes that the Stipulating Parties collectively represent the utility, the public interest and the interests of all PEC customer classes, and include all customers and customer groups participating in this proceeding. The only opponents are the Environmental Intervenors.

On January 29, 2009, PEC filed the rebuttal testimony of Witnesses Williams and Laura Bateman. On February 5, 2009, the Environmental Intervenors filed the surrebuttal testimony of Messrs. Henderson and Hornby.

The evidentiary hearing was held February 12, 2009 as scheduled.

PEC witness Williams testified that, contemporaneously with the instant proceeding, PEC was involved in a Demand Side Management/Energy Efficiency ("DSM/EE") cost recovery proceeding in North Carolina. He explained that the North Carolina proceeding not only involved the establishment of a DSM/EE cost recovery procedure but also the actual establishment of a DSM/EE cost recovery rider. Witness Williams testified that following the filing of PEC's June 27, 2008 Application with this Commission, PEC entered into simultaneous and parallel negotiations with the North Carolina Utilities Commission Public Staff and Wal-Mart in North Carolina; and ORS, Nucor and Wal-Mart in South Carolina to mutually agree upon an appropriate DSM/EE cost recovery mechanism. PEC reached agreement with the North Carolina Public Staff and Wal-Mart first and, therefore, PEC revised its proposed DSM/EE cost recovery procedure in this proceeding to be consistent with the settlement reached in North Carolina and filed the revised procedure with Witness Williams' January 8, 2009 testimony as his Exhibit No. 1. Witness Williams testified that PEC's January 14, 2009 filing clarified and combined into a single document PEC's Application as revised to be consistent with the North Carolina settlement. Thereafter, ORS, Wal-Mart, Nucor and PEC reached an agreement on the DSM/EE Procedure which closely reflects PEC's January 14, 2009 filing. The agreed upon DSM/EE Procedure and Stipulation Agreement were filed with the Commission on January 23, 2009.

BASIS FOR PEC'S APPLICATION

Witness Williams testified that PEC was requesting the establishment of its proposed DSM/EE Procedure because the electric industry is going through a transformation. He explained that traditionally an electric utility's duty was to provide a reliable supply of electricity to its customers at the lowest reasonable price. How the utility's customers used the electricity generated by the utility was left to the discretion of the customer. Witness Williams further testified that any attempt to influence a customer's use of electricity was primarily limited to the use of price signals, such as those employed by PEC in its time-of-use and curtailable rate schedules pursuant to which PEC provides the customer a credit if the customer will allow PEC to interrupt the supply of electricity to the customer during times of peak demand. He further explained that given the relatively low price of electricity in South Carolina, very few DSM/EE Programs have been cost-effective. Because South Carolina has such low electricity rates, customers find the use of electricity to heat and cool their homes and businesses, as well as run appliances and machines, to be economically beneficial.

Witness Williams testified that, while South Carolina continues to enjoy some of the lowest electricity rates in the nation, the cost of coal and natural gas has increased precipitously over the past few years, resulting in increases in electricity rates. In addition, South Carolina's electric utilities have "grown into" the base load generation facilities constructed over the last two decades and all of South Carolina's electric providers are in the position of having to add a substantial amount of base load generation during the next ten (10) years. The cost of this new base load generation is forecasted to be substantially greater than the average cost of the utilities' existing generation mix.

As a result, Witness Williams explained that DSM/EE programs are expected to become more cost-effective and therefore much more prevalent and expansive than has historically been the case. According to Witness Williams, while these programs may be cost effective from the customers' perspective, it must be recognized that DSM/EE Programs, particularly EE Programs, are designed to encourage customers to not purchase the utility's electricity. In other words, through these programs and measures, utilities are spending money to encourage their customers not to buy their product. He emphasized this is completely inconsistent with any normal business plan and that this reduction in energy sales results in a loss of revenue which imperils the utility's ability to recover its costs. To properly compensate and encourage PEC to invest in and promote such programs, Witness Williams testified that it is appropriate to provide PEC with timely cost recovery of all DSM/EE costs incurred, a mechanism to recover net lost revenues and an appropriate incentive for promoting such programs.

The Commission agrees with PEC witness Williams and believes that South Carolina's utilities should aggressively pursue and implement cost effective DSM/EE programs for the benefit of their customers.

Witness Williams explained that the DSM/EE Procedure agreed to by PEC, ORS, Nucor and Wal-Mart, in particular the program cost recovery, recovery of net lost revenues and an incentive/reward element, is consistent with S.C. Code Ann. § 58-37-20 (Supp. 2008). The Commission recognizes that this statute authorizes the Commission to adopt procedures that encourage electric utilities to invest in cost effective energy efficient technologies and energy conservation programs. The Commission further recognizes that the statute further provides that if the Commission chooses to adopt such procedures these procedures must:

1. Provide incentives and cost recovery for electric utilities that invest in energy supply and end-use technologies that are cost effective, environmentally acceptable, and reduce energy consumption or demand;
2. Allow electric utilities to recover their costs and obtain a reasonable rate of return on their investment in qualified demand-side management programs sufficient to make these programs at least as financially attractive as construction of new generating facilities; and
3. Establish rates and charges that ensure that the net income of an electric utility after implementation of specific cost effective energy conservation measures is at least as high as the utility's net income would have been if the energy conservation measures had not been implemented.

ELEMENTS OF THE PROPOSED DSM/EE PROCEDURE

The DSM/EE Procedure consists of an annual rider to allow PEC to recover the following costs and incentives: (1) the actual costs incurred in providing the DSM/EE programs (including a return on PEC's investment)¹; (2) the recovery of net lost revenues resulting from these programs²; and (3) an incentive equal to 8% of the net present value of the net benefits associated with each DSM program as calculated using the Utility Cost Test, and 13% of the net present value of the net benefits associated with each EE program as calculated using the Utility Cost Test.

¹ DSM/EE expenses will be deferred and amortized over a ten (10) year period using a levelized rate. The unamortized balance will earn a return equal to PEC's rate of return authorized in its last general rate case. DSM/EE capital expenditures will be depreciated over the useful life of the equipment with a return based upon PEC's current capital structure, current embedded cost of debt, and cost of equity as determined in PEC's last general rate case.

² The term "net lost revenues" means the revenue losses, net of marginal cost avoided at the time of the lost kilowatt-hour sales or in the case of purchased power, in the applicable billing period, incurred by PEC as a result of a new DSM/EE program. Net lost revenues are also net of any increases in revenues resulting from activity by PEC's public utility operations that causes a customer to increase demand or energy consumption. PEC will be allowed to recover net lost revenues for three years from the installation of a measure as part of a DSM/EE program, or until PEC's next general rate case when any lost revenues are addressed, whichever time period is shorter.

Witness Williams explained in detail how these three elements of the DSM/EE Procedure are authorized by and consistent with S.C. Code Ann. § 58-37-20. He testified that the statute requires that a utility be allowed to recover its costs and obtain a reasonable rate of return on its investment. The DSM/EE Procedure does that in allowing PEC to recover all of its costs incurred in offering a DSM/EE program, including a return on any capital expenditures made in furtherance of such programs.

Regarding the second element of the DSM/EE Procedure (the recovery of net lost revenues), the statute provides that the Commission is to establish rates that ensure that the net income of the utility after implementation of DSM/EE programs is at least as high as the net income would have been if the DSM/EE programs had not been offered. By allowing PEC to recover its net lost revenues, this requirement of the statute is met.

Finally, regarding the third element of the DSM/EE Procedure, the recovery of an incentive/reward, the statute provides that the rate established by the Commission must be sufficient to make the utility's DSM/EE programs at least as financially attractive as construction of new generation facilities. By definition, investments in supply-side generating facilities are much more capital intensive than demand-side resources and therefore have the potential to produce higher earnings for the utility. Allowing PEC to recover 8% for DSM programs and 13% for EE programs of the net present value of the net benefits associated with such programs as calculated using the utility cost test is a reasonable incentive/reward under S.C. Code Ann. § 58-37-20 for implementing DSM and EE programs, fairly balancing the interests of the utility, consumers, and the public interest.

Thus, the Commission concludes that the DSM/EE Procedure is entirely consistent with S.C. Code Ann. § 58-37-20 and is a transparent and easily understood cost recovery procedure.

TREATMENT OF INDUSTRIAL AND LARGE COMMERCIAL CUSTOMERS

Witness Williams explained that all customer classes are not addressed in the same manner under the DSM/EE Procedure. This is because there are substantial differences between small customers and large customers in their awareness of the benefits of DSM/EE programs and their willingness and ability to develop and implement them on their own. Large commercial customers (defined as customers that consume at least a million kilowatt-hours per year) and industrial customers are typically very conscious of their energy costs and already have a substantial incentive to invest in DSM/EE programs tailored to each individual customer's unique facilities and production processes because it is cost effective for them to do so. These customers themselves are better positioned than anyone else to make the decision on whether a particular DSM or EE program would be suitable, from both a cost effectiveness and operational perspective, for their plants and facilities.

Since the incentive and opportunity already exists for large commercial and industrial customers to invest in DSM/EE programs even without the proposed DSM/EE Procedure, such customers should not be required to contribute to the cost of the programs being provided to those customers who have not made such investments and are being provided incentives to do so by PEC. In fact, requiring large commercial and industrial customers to fund PEC's DSM/EE programs could be viewed as anticompetitive where a customer that already has its own programs is being required to pay for PEC programs that are or might be used by its competitors. Moreover, large customers are simply not in a position to bear additional costs for EE and DSM programs that do not apply to them – imposing such costs on these types of customers, while many other states do not, would have a negative impact on business retention and economic development in South Carolina. The Commission recognizes that these concerns are particularly

acute today, when large commercial and industrial customers are facing devastating economic conditions and extraordinary competitive pressures.

Customers most likely to participate in and directly benefit from utility-sponsored DSM/EE programs are the residential and small commercial segments. Thus, PEC's programs will target these customer segments. By participating in the DSM/EE programs these customers will receive the direct and tangible benefits of lower energy costs. It is appropriate that the customer segments enjoying the benefits also have responsibility for the costs of the programs, and that those larger customers most likely to finance and install energy efficiency improvements on their own should not also be required to pay for utility-sponsored programs that do not directly provide benefits to them.

Therefore, the DSM/EE Procedure does not provide for any of the costs of new DSM/EE programs to be assigned to any large commercial customer or industrial customer that notifies PEC that it is opting out of participation in PEC's DSM/EE programs. As a result, such customers have the option to participate or not. Any customer that elects not to participate in PEC's DSM/EE programs, but subsequently elects to participate in any new DSM/EE program, will lose the right to be exempt from payment of the annual rider for five (5) years or the life of the program, whichever is longer (life of the program means either the capitalization period over which PEC will amortize or depreciate the costs associated with the program or the anticipated period for the program to reach maximum penetration).

Wal-Mart witness Chriss confirmed that large customers, such as Wal-Mart constantly search for and implement those DSM/EE programs that are cost effective for their business operations. Witness Chriss gave numerous examples of actions taken by Wal-Mart to lower its energy costs. In addition, Witness Williams testified that Nucor, a steel recycler and PEC's

largest customer, has been served for many years under a time-of-use curtailable rate. Witness Williams further testified that Nucor's rate already provides significant peak demand reduction benefits of the type PEC hopes to achieve through the proposed DSM/EE Procedure.

The Commission agrees that large commercial customers and industrial customers should be allowed to opt-out of PEC's DSM/EE programs as provided for under the DSM/EE Procedure. Based on the evidence in this proceeding, these customers have a strong incentive to implement DSM/EE measures regardless of the proposed DSM/EE Procedure, and it is unreasonable to require such customers to pay for PEC's programs, unless they specifically choose to opt into PEC's programs. By making it easy for such customers who are not interested in participating to opt-out, the opt-out procedure will support business retention and economic development, and will be easy for PEC to administer. Further, no party opposed the opt-out option and no party presented any evidence that the opt-out mechanism provided for in the DSM/EE Procedure is unreasonable.

Finally, under the DSM/EE Procedure, the costs associated with new DSM/EE programs will be allocated between PEC's North and South Carolina retail jurisdictions, with DSM related costs allocated based on a one-hour coincident peak demand and EE related costs allocated based on energy sales. The DSM/EE Procedure also provides that each EE or DSM program's cost will be allocated to and recovered from those South Carolina retail rate classes eligible to participate in such program. This is a reasonable methodology for the allocation and recovery of such costs. In addition, no other party advocated any other methodology for the allocation and recovery of such costs.

ENVIRONMENTAL INTERVENORS' ALLEGATIONS

The Environmental Intervenor's witnesses Henderson and Hornby questioned the DSM/EE Procedure in several ways. Witness Henderson recommended the Commission condition its approval of the DSM/EE Procedure on PEC: focusing its efforts on EE programs rather than DSM programs: "employing a comprehensive program development process with annual performance targets," and the creation of an advisory group to determine which DSM/EE programs PEC should offer its customers. Witness Hornby alleged that: (1) PEC had not proven that the cost-recovery mechanism contained in the DSM/EE Procedure will produce just and reasonable rates because PEC had not provided actual forecasted DSM/EE costs for use in determining the level of rates to be produced by the Procedure; (2) PEC had not proven that receiving a return on PEC's DSM/EE costs and an incentive based upon net savings was reasonable; (3) PEC had not proven that the recovery of net lost revenues is the best method to address the lost sales impact of DSM/EE programs; and (4) the Procedure should include portfolio performance targets.

PEC witnesses Williams and Bateman convincingly rebutted the Environmental Intervenor's witnesses on each of these points. In addition, on cross-examination both Messrs. Henderson and Hornby seemed to agree that PEC had addressed all of their points and concerns.

Regarding Witness Henderson's recommendation that PEC be required to favor EE programs over DSM programs, PEC witness Williams explained that S.C. Code Ann. §§ 58-37-10 et seq. (Supp. 2008) requires South Carolina's electric suppliers to develop 15-year integrated resource plans which must contain the utility's plan "for meeting the requirements shown in its forecast in an economic and reliable manner, including both demand-side and supply-side options." "Demand-side" is defined as including both demand-side resources and energy

efficiency. Thus, witness Williams concluded and the Commission agrees that the South Carolina General Assembly has determined that the State's electric utilities are to consider equally, and implement both, DSM and EE programs as an integral part of their resource mix. Both DSM and EE programs have a strong role to play in utilities cost-effectively meeting their resource needs. As further addressed below, witness Williams also explained that the actual mix of DSM and EE resources a utility should offer depends on its resource needs, customer mix, climate and rates. On cross-examination witness Henderson agreed that all of these factors must be considered.

Turning to witness Henderson's recommendation that PEC use a comprehensive DSM/EE program development strategy, PEC Witness Williams explained that PEC has done and will continue to do just that. He testified that in 2007, PEC announced a commitment to defer 1,000 MW of power generation requirements over the next ten years through DSM and EE programs. This commitment is part of PEC's long-term, balanced energy strategy to meet the future energy needs of its customers in the Carolinas. PEC has developed several cost-effective programs to help achieve the 1,000 MW reduction in peak demand and associated energy savings. PEC has assembled a staff which is responsible solely for PEC's DSM/EE activities and which reports to the Vice President, Efficiency and Innovative Technology. Witness Williams explained that PEC has contacted other utilities and used well known and respected consulting firms to identify the best programs and practices nation-wide and adapt them to the realities in the Carolinas. Witness Williams stated that these DSM/EE experts are some of the same ones that helped design DSM/EE programs in several of the states witness Henderson recommended South Carolina emulate.

Witness Williams testified that Witness Henderson's references to and reliance on what other states have done with regard to DSM/EE is misplaced. Witness Williams explained that when evaluating what other states have done the Commission should take into account differences in a utility's resource needs, rates, and customer mix. The proper mix of DSM/EE programs is driven by the resource needs of the utility, the economic and market potential for various measures, and the utilities' rates and avoided costs. Witness Williams explained that in states like California, where average electric rates are 78% higher than in South Carolina, or New York with average rates more than double the rates in South Carolina (212%), and commensurately high avoided costs, customers already have a strong incentive to seek out and implement DSM and EE measures, even in the absence of utility sponsored programs. In addition, such high rates and avoided costs cause many more programs and measures to be cost effective than is the case in South Carolina, which has average rates 21% below the national average.

Witness Williams stated that the utility's mix of customers must also be considered when designing and selecting DSM/EE programs. For a utility with a large portion of its load comprised of industrial customers and large commercial customers, its DSM/EE efforts will be materially different from a utility with predominately small commercial and residential load. As explained earlier, large commercial customers, such as Wal-Mart, and industrial customers are constantly evaluating and making investments in energy efficiency on their own in order to minimize their cost of doing business. These large customers conduct research and perform engineering evaluations to identify and implement improvements that are cost effective. That is why in some states, such as North Carolina, these customers are allowed to opt-out of participating in utility sponsored programs and associated rate surcharges. Such opt-out

provisions are significant factors that can drastically alter any state-to-state comparisons. PEC is proposing to allow such an opt-out opportunity for its industrial and large commercial customers in South Carolina for the reasons described above, and the Commission has found such an opt-out provision to be reasonable and appropriate. PEC estimates that potential opt-out eligible customers account for approximately 49% of its South Carolina retail energy sales (kWh).

Finally, witness Williams testified that the DSM and EE experiences in states like New York and California should not be perfunctorily applied to South Carolina due to regional differences in climate, fuel choices, demographics, customer mix, appliance saturation, housing types, and overall energy policies.

On cross-examination Environmental Intervenors' witness Henderson readily agreed that the particular situation faced by a utility must be considered in selecting, designing and implementing DSM/EE programs. He also agreed that a utility's forecasted resource needs (whether baseload, intermediate or peaking) must be considered as well as the utility's existing resource and customer mix, and the utility's rates compared to other states.

The Commission finds that all of these factors mitigate against South Carolina simply copying what some other states have done in regards to DSM/EE.

With regard to PEC's actual DSM/EE program selection process, witness Williams testified that because North Carolina law requires PEC to obtain North Carolina Utilities Commission ("NCUC") approval prior to offering any new DSM/EE programs and South Carolina law does not, PEC intends to wait until the NCUC approves a DSM/EE program before offering the program in South Carolina. This is necessary and appropriate because the NCUC may revise or reject a proposed DSM/EE program. If the NCUC were to do so, and PEC had already begun offering the DSM/EE program in South Carolina, PEC could find itself offering

different programs in the two states leading to a deterioration of the overall cost effectiveness of the program.

Witness Williams testified that in North Carolina, PEC has obtained approval of: a residential heat pump, central air conditioner and water heater DSM program; a residential new construction EE program; and a commercial, industrial and governmental new and retrofit EE program. In addition, witness Williams explained that PEC has four more DSM and EE programs awaiting NCUC approval. He stated that these programs are not all of the programs PEC intends to offer. Rather, PEC plans to continue to develop additional programs that will be added to PEC's portfolio of programs over the coming months and years, including a low income weatherization program, an appliance program, and a residential lighting program.

Witness Williams testified that PEC intends to offer a comprehensive and diverse portfolio of cost-effective DSM/EE programs as is evident by the initial set of programs filed for approval in North Carolina. He stated that the initial set of programs filed in North Carolina is completely consistent with the intended market sector and relative targeted measures as outlined by witness Henderson in his testimony, that is: Existing Residential Sector; New Construction Residential Sector; New Commercial Construction; and Existing Commercial Buildings. In fact, witness Henderson agreed on cross-examination that PEC's proposed programs are very similar to those being implemented by the Arizona Public Service Company ("APS"), a utility which witness Henderson recommended this Commission look to for guidance in this regard. (Hearing Exhibit No. 7)

Importantly, witness Williams explained that comparisons of South Carolina to states like New York and California are of little value in evaluating DSM/EE programs for a variety of reasons. One of the most important reasons is the higher electric rates in those states make

DSM/EE programs much more cost effective as compared to South Carolina. In addition, these other states have much more mature DSM/EE programs than PEC. Therefore, one would expect both their DSM/EE expenditures as well as their load and energy reductions to be significantly higher than those proposed by PEC. Williams testified that the fact that these states have been engaged in DSM/EE efforts for so long and yet still have rates twice as high as those in South Carolina should caution South Carolina against blindly adopting the same programs and practices. Additionally, the existence of and the ability of large customers to opt-out of a utility sponsored DSM/EE program impact the results which a utility can reasonably expect to achieve; and neither New York nor California have such opt-out provisions. The Commission agrees that PEC's DSM/EE programs must be designed for the unique and special needs of South Carolinians.

Witness Williams stated that PEC agrees with witness Henderson that it is important for PEC to develop a network of private contractors and energy service providers that will be performing the work. To this end, witness Williams stated that PEC has made plans to incorporate ongoing training and education specific to each program delivery channel including architects, engineering firms, builders, trade allies, and contractors as well as many of the professional organizations which represent these groups. Mr. Williams testified that a whole-systems approach is needed to ensure the successful launch of PEC programs, and therefore PEC is committed to engaging the relevant participants for each program. The Commission agrees with and supports PEC's efforts in this area.

Witness Williams offered up PEC's Home Advantage Program (residential new construction) as an example of its efforts in designing appropriate programs for the Carolinas. He stated that this program focuses on market transformation to more efficient residential

building construction by providing incentives to builders who commit to the Energy Star platform and upgrade their HVAC equipment. Currently, this market is largely untapped in South Carolina and lacks adequate infrastructure, including qualified Home Energy Rating System (“HERS”) raters, trained builders and informed realtors, all of which are fundamental to successful program participation. To address this need, PEC is investing in resources to help identify and support the training of individuals in its South Carolina service territory that can serve as new HERS raters. PEC also plans to offer classes in South Carolina, including builder and training seminars, that will provide a sound understanding of Energy Star construction and marketing; thereby growing the number of qualified energy professionals needed to successfully implement the program.

Witness Williams testified that PEC’s starter portfolio of DSM/EE programs begins with a core set of programs targeting broad market segments with straightforward, measure-based incentives. As experience is gained, PEC will add more targeted and complex programs. Witness Williams explained that PEC has selected an initial set of programs and measures that help balance the resource planning needs, performance risks, regulatory interests, costs, and customer satisfaction objectives specific to its customer base. The initial programs incorporate design and concepts that have a proven track record of providing benefits in other regulatory jurisdictions around the country.

Witness Williams stated that the program designs adopted by PEC thus far were developed with the assistance of consulting firms and professionals that have extensive roles and experience providing similar services to many of the utilities cited by Witness Henderson. As an example, PEC’s proposed comprehensive Commercial, Industrial, and Governmental Energy Efficiency (“CIG EE”) Program was designed and will be implemented with the assistance of the

same professional consultant used to design and implement a comparable program at APS. A comparison of the CIG EE program proposed by PEC with that of APS reveals strong similarities. Witness Henderson agreed that PEC's proposed mix of DSM/EE programs is very similar to those offered by APS. Witness Henderson also specifically cited APS as a utility that achieved quick, large impacts even though its energy efficiency endeavors were relatively new. PEC anticipates similarly quick, large positive impacts specific to the climate, local economy, and market demographics of its South Carolina service territory.

According to witness Williams, all of the programs PEC has proposed thus far pass the relevant cost benefit tests and result in significant reductions in energy ("kWh") and demand ("kW") consumption. Witness Williams explained that witness Henderson's observations that PEC's proposed programs could or should contain a different mix of measures is therefore somewhat irrelevant. The bundle of measures constituting a program can always be revised by adding or deleting measures or modifying them in some way. In fact, as mentioned earlier, as the market changes and PEC's resource needs change, PEC will revise these programs. While debating whether a program should have one more measure or a different incentive may provide an opportunity for theoretical discussion, it does little to advance the goal of rolling out DSM/EE programs on a timely basis. Whether the initial mix of programs offered by PEC represents the optimal mix of measures can best be determined after they have been subject to a measurement, verification and evaluation process, as well as an analysis of market acceptance.

Witness Williams testified that PEC is employing third-party industry experts to assist in developing its programs and that, based upon this expert advice, comparisons with other successful programs, and PEC's own internal resources, PEC has developed an initial core set of programs which appear to provide a robust set of cost-effective opportunities to every market

sector. PEC has further indicated that it will continue to add to this core portfolio utilizing the same basic principles that leverage professional expertise and program benchmarking, combined with the experience that it gains through initial program offerings and market acceptance.

Turning to witness Henderson's recommendation that the Commission establish annual performance targets, on cross-examination he acknowledged that APS, a utility located in a state he recommends South Carolina emulate, does not have performance targets. With regard to California, which has adopted performance targets, it was established during the cross-examination of witness Hornby that the California Public Service Commission opened a rulemaking on February 4, 2009 to review the effectiveness of its DSM/EE program cost recovery/incentive procedure. Witness Hornby acknowledged that the California process has only been in place since early 2007, yet it is already conducting another proceeding to determine whether the entire process should be revised. The Commission takes judicial notice of the California Commission's February 4, 2009, order in which it states it is instituting the rulemaking on its own motion to "adopt, repeal, or amend rules, regulations, and guidelines for the electric and gas utilities" and stated that "We believe it is necessary to consider a more transparent, more streamlined and less controversial RRIM [risk/reward incentive mechanism] program. This may require making small but significant changes to the existing RRIM, or may require wholesale adoption of a new incentive mechanism." (Hearing Exhibit No. 5)

Furthermore, PEC rebuttal witness Bateman explained in detail why performance targets are not needed. She testified that the Program Performance Incentive ("PPI") contained in the DSM/EE Procedure provides a strong incentive to PEC to make every program as successful as possible because the award is based upon a percentage of the savings resulting from the program as measured by the Utility Cost Test. Thus, as the program becomes more successful, the

incentive award will increase. Witness Bateman stated that establishing performance targets will not provide any greater incentive to offer DSM/EE programs or make such programs more successful than the incentive created by the PPI mechanism. She stated that this principle is confirmed by Environmental Intervenors' witness Hornby in his recommendation of an incentive tied to actual performance, which is exactly what the PPI does.

More importantly, witness Bateman testified that establishing overall performance targets is a complex and somewhat subjective undertaking. In order to make any attempt to establish realistic targets, a DSM/EE market potential study must be performed. The results of the market potential study are essential to any attempt to establish realistic and achievable overall portfolio targets. Without these results, any targets are only guesses at what can reasonably be accomplished through a portfolio of DSM or EE programs. Witness Bateman explained that PEC has commissioned such a study that will be complete by the end of March 2009.

Even then, as testified to by witness Bateman, the results of a market potential study alone are not adequate to create valid goals. Several additional factors must be known before target goals can be established with any level of precision. For example, the utility must gain experience with the DSM/EE program implementation process, and determine customer acceptance rates. Witness Bateman explained that if appropriate, the issue of performance targets can be revisited in future DSM/EE cost-recovery proceedings after these critical factors are known. That is one of the reasons that the Stipulation Agreement contemplates a re-evaluation of the PPI after three years. Witness Hornby appeared to agree with this re-evaluation proposal.

The Commission agrees that the PPI contained in the DSM/EE Procedures provides the greatest incentive possible to encourage PEC to aggressively pursue cost effective DSM/EE

programs. The Commission finds that an incentive that grows as DSM/EE program savings grow provides the utility with a substantial incentive to pursue cost effective programs and that performance targets are not appropriate at this time.

Turning to witness Henderson's final recommendation, that the Commission require PEC to establish an Advisory Group, PEC witness Williams testified that the DSM/EE Procedure and the Stipulation Agreement contemplate PEC soliciting the input of all parties to its previous cost-recovery proceeding to assist in PEC's development of new DSM/EE programs. Witness Williams stated that no further process for input to PEC's resource plan or DSM/EE efforts is appropriate. He testified that PEC alone is responsible for providing reliable, low-cost electricity to its customers and that PEC alone must defend the prudence, justness and reasonableness of its costs incurred in doing so. Witness Williams stated that PEC's resource planning responsibilities should not be turned into a committee process open to any person or entity that wishes to voice an opinion or which may focus on only one aspect of resource planning while ignoring the broad scope of responsibilities and objectives that prudent resource planning requires. Witness Williams explained that while a utility should always be open to others' ideas, a utility must be able to reject the ideas and proposals it finds unreasonable or inappropriate. The Commission finds that PEC will solicit and obtain input regarding new DSM programs and thus no advisory committee is necessary.

In response to witness Hornby's allegation that PEC had not proven that the cost-recovery mechanism contained in the DSM/EE Procedure will produce just and reasonable rates because PEC had not provided actual forecasted DSM/EE costs for use in determining the level of rates to be produced by the Procedure, PEC witness Bateman explained that the cost-recovery mechanism contained in DSM/EE Procedure is appropriate for all cost-effective DSM/EE

programs and will produce just and reasonable rates. She explained that the Procedure allows PEC to recover its actual DSM/EE costs as specifically contemplated by S.C. Code Ann. § 58-37-20. These costs will be reviewed by the Commission in the annual proceeding provided for in the DSM/EE Procedure to ensure that only PEC's just and reasonable costs are recovered via the annual rider. The Procedure provides PEC the option of deferring and amortizing such costs over 10 years with a carrying cost equal to PEC's last Commission-approved overall return. This method allows PEC to only recover its just and reasonable costs, and causes the rider to be much lower in the early years than would be the case if all expenses were recovered in the year incurred, which is the method advocated by the Environmental Intervenors. This alternative method is not in the public interest as it causes rates to be much higher in the early years of a program before PEC's customers begin realizing the benefits of the program.

Witness Bateman explained that the net present value of expensing all costs in the year incurred and deferring and amortizing is the same, but the deferral option included in the DSM/EE Procedure spreads out the cost for recovery purposes in order to keep the rider as low as possible. It also better matches cost recovery with the timing of the benefits of the programs. Witness Bateman stated, and the Commission agrees, there is no need to have actual DSM/EE costs in order to determine whether this portion of the mechanism is reasonable. A utility should be allowed to recover its just and reasonable costs as this element of the Procedure contemplates.

Witness Bateman testified that the second element of the DSM/EE Procedure cost recovery mechanism allows PEC to recover its net lost revenues resulting from its DSM/EE programs for three years. Witness Bateman noted that witness Hornby seemed to support such a mechanism in his testimony, although he seemed to suggest that there may be another unspecified method for addressing the impact of lost sales.

Witness Bateman testified that to the extent PEC's DSM/EE programs cause its customers to reduce their consumption of electricity, the DSM/EE Procedure makes PEC whole by allowing it to recover its actual net lost revenues: i.e., those revenues PEC would otherwise have received to cover its fixed costs if it had not offered the DSM/EE programs. Again, actual DSM/EE program lost revenue numbers will add nothing to a determination as to whether it is just and reasonable to allow PEC to recover such lost revenues. Either it is appropriate to allow recovery of such net lost revenues or it is not, and the Commission finds that such recovery is appropriate.

Finally, witness Bateman explained that the DSM/EE Procedure allows PEC to recover an incentive to encourage it to pursue DSM/EE resources rather than supply-side resources. The incentive provides for PEC to receive an incentive of 8% of the net present value of the Utility Cost Test savings for DSM programs and 13% of the net present value of the Utility Cost Test savings for EE programs. The definition of the Utility Cost Test is set forth in the Procedure. It is a nationally recognized test and the method for calculating it is standardized. The parties to the Stipulation have agreed that incentives of 8% and 13% of these savings as determined by the Utility Cost Test are appropriate. The actual rates resulting from such incentives will provide no additional value in determining whether these are reasonable incentives.

Witness Bateman emphasized that all three elements of the mechanism are expressly supported and justified by S.C. Code Ann. § 58-37-20. In addition, she noted that all of the South Carolina electric utility statutes regarding cost recovery were passed by the South Carolina General Assembly without establishing the level of costs that would actually be recovered pursuant to such statutes. This is true for the statutes governing the establishment of base rates, the fuel clause and the new Base Load Review Act. These statutes, like the DSM/EE Procedure,

establish cost-recovery procedures. The Commission is then responsible for ensuring that the rates produced by such procedures are just and reasonable by verifying that the costs upon which the rates are based were prudently incurred and are just and reasonable. Therefore, it is not necessary to consider the specific costs to be recovered through a cost-recovery procedure in order to determine whether the procedure itself is appropriate.

On cross-examination, in order to fully respond to Witness Hornby's assertions, PEC witness Bateman provided the Commission with actual rates that would be produced by the DSM/EE Procedure based upon three representative DSM/EE programs that are currently approved or being considered by the NCUC. Thus, the Commission has been provided the opportunity to review an example of how the Procedure will be applied and the estimated resulting rates. Given that S.C. Code Ann. § 58-37-20 expressly allows recovery of the categories of costs included in the Procedure, while the numerical examples are insightful, they are unnecessary to support a finding by this Commission that the DSM/EE Procedure is appropriate and should be approved.

Finally, witness Bateman referred to the Environmental Intervenors' brief filed in Commission Docket No. 2007-358-E, the Duke Energy Save-A-Watt proceeding, to demonstrate the falsity of witness Hornby's assertions. On page 19 of that brief, under the heading "Relief Requested," the Environmental Intervenors asked the Commission to "Approve a compensation mechanism for Duke's energy efficiency gains under the Save-A-Watt programs including the following: (i) Recovery of reasonable and prudent program costs; (ii) Compensation for three years of net lost revenues; and (iii) A bonus incentive based on a percentage of shared savings of 5% for demand response and a range of 10-12% for conservation programs if savings meet or exceed targets described in paragraph A.4 above." (Hearing Exhibit No. 6) No mention is made

in this brief that approval of such a methodology be conditioned upon Duke first using actual DSM/EE costs and savings numbers to determine the level of the rider. As noted by witness Bateman, it is impossible not to observe that the cost-recovery procedure proposed by the Environmental Intervenors in the Duke SAW docket is remarkably similar to that contained in the DSM/EE Procedure proposed by PEC, Nucor, Wal-Mart, and ORS in this docket.

Turning to witness Hornby's allegation that PEC has not proven that receiving a return on PEC's DSM/EE costs and an incentive based upon net savings is reasonable, witness Bateman conclusively demonstrated that receipt of a return on PEC's capital and deferred DSM/EE costs and an incentive is fully justified and consistent with S.C. Code Ann. § 58-37-20. Witness Bateman began by explaining again that the first element of the Procedure is full recovery of all DSM/EE costs incurred. Again, S.C. Code Ann. § 58-37-20 specifically requires the Commission to allow a utility a reasonable opportunity to recover its DSM/EE costs, as it provides that a utility must be allowed to recover its costs and obtain a reasonable rate of return on its investment in DSM/EE programs sufficient to make these programs at least as financially attractive as construction of new generating facilities.

Under the Procedure, if PEC defers recovery of its DSM/EE costs, it will incur carrying costs. Witness Hornby admitted this on cross-examination. The cost of money (the carrying costs) associated with PEC's unrecovered DSM/EE costs is a real cost. Again, witness Hornby admitted on cross-examination that PEC's cost of money is a cost, not an incentive and that it is a legitimate part of PEC's revenue requirement. All PEC is allowed to recover under the Procedure is its actual cost of money as approved by the Commission in its last rate case. As witness Bateman correctly observed this is not an incentive, but merely a mechanism to provide

for the recovery of costs associated with developing, implementing and managing the DSM/EE programs.

In adopting S.C. Code Ann. § 58-37-20, witness Bateman explained that the General Assembly recognized that a utility must be provided both cost recovery and incentives for its DSM/EE programs. Obviously, the greater the incentive, the more aggressively the utility will pursue such programs and measures. The exact level of the appropriate incentive is difficult, if not impossible, to demonstrate empirically. All that can be stated with certainty is that the incentive needs to be real and meaningful enough to cause the utility to develop new DSM/EE programs and measures to satisfy a resource need rather than a supply-side resource that does not result in lost kilowatt-hour sales and return on investment.

As noted in PEC's June 2008 Application, PEC initially proposed an incentive equal to 50% of the net present value of the net savings of the programs and measures being offered, as determined by the Utility Cost Test. Through negotiations and discussions, ORS, PEC, Nucor and Wal-Mart agreed upon incentives of 8% for DSM programs and measures and 13% for energy efficiency programs and measures.

Witness Bateman testified that the pre-tax 8% and 13% incentive levels contained in the DSM/EE Procedure are the result of arm's-length negotiations between the parties to the Stipulation Agreement. As admitted by witness Hornby during cross-examination, arm's length negotiations are the very methodology he would expect to be used to establish the appropriate incentives. To the extent witness Hornby wishes to cast them as arbitrary, they are no more arbitrary than any other level of incentives including the 12% pre-tax incentive adopted by California for EE programs or the 5% for DSM and 10-12% for EE incentives recommended by the Environmental Intervenors in the Duke SAW proceeding. The DSM/EE Procedure's

performance incentives provide a reasonable incentive to encourage PEC to pursue new DSM/EE programs, consistent with the statute. Furthermore, Environmental Intervenor witness Henderson admitted on cross-examination that the APS cost recovery procedure has incentives based on net savings.

Thus, both a return on unamortized DSM/EE costs and an incentive are necessary and are provided for by the statute. A return on unamortized DSM/EE costs is essential to allow PEC to recover its costs, and an incentive is essential to encourage PEC to aggressively pursue DSM/EE resources rather than supply-side resources in continuing to meet PEC's obligation to provide reliable service to all customers.

With regard to witness Hornby's allegation that PEC has not proven that the recovery of net lost revenues is the best method to address the lost sales impact of DSM/EE programs, as explained earlier, witness Hornby does not offer an alternative methodology, and his own clients recommended the recovery of net lost revenues by Duke in its SAW proceeding. In addition, PEC witnesses Bateman and Williams explained in detail why recovery of net lost revenues is appropriate and consistent with S.C. Code Ann. § 58-37-20.

Finally, turning to witness Hornby's allegation that the Procedure should include portfolio performance targets, this issue has been addressed earlier in response to witness Henderson's same assertion.

CONCLUSION

The Environmental Intervenor are the only parties objecting to PEC's DSM/EE Procedure. The Procedure is entirely consistent with S.C. Code Ann. §58-37-20. PEC's witnesses completely rebutted every issue raised by the Environmental Intervenor and their own witnesses basically acknowledged the fallacy of their position during cross-examination. Thus, the Commission

concludes that the Stipulation Agreement and the DSM/EE Procedure contained therein is consistent with S.C. Code Ann. § 58-37-20, is in the public interest, and should be approved.

IT IS THEREFORE ORDERED THAT:

- 1) The Stipulation Agreement and the DSM/EE Procedure contained therein are approved.
- 2) PEC shall file a proposed DSM/EE rider on May 1, 2009 consistent with the DSM/EE Procedure.

This order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:

Elizabeth B. Fleming, Chairman

ATTEST:

John E. Howard, Vice Chairman
(SEAL)

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2008-251-E

IN RE:)
Application of Carolina Power and Light)
Company d/b/a Progress Energy Carolinas,)
Incorporated for the Establishment of)
Procedures for DSM/EE Programs)

CERTIFICATE OF SERVICE

I, Len S. Anthony, hereby certify that the Joint Proposed Order of Progress Energy Carolinas, Inc. and the Office of Regulatory Staff has been served on all parties of record either by hand delivery, e-mail, or by depositing said copy in the United States mail, postage prepaid, addressed as follows:

Holly Rachel Smith
Russell W. Ray, PLLC
6212-A Old Franconia Road
Alexandria, VA 22310
holly@raysmithlaw.com

Robert R. Smith, II
Moore & Van Allen, PLLC
100 North Tyron St., Suite 4700
Charlotte, NC 28202
robsmith@mvalaw.com

Shealy Boland Reibold
Office of Regulatory Staff
1401 Main Street, Suite 900
Columbia, SC 29201
sreibol@regstaff.sc.gov

Thomas S. Mullikin
Moore & Van Allen, PLLC
100 North Tryon Street, Ste. 4700
Charlotte, NC 28202
tommullikin@mvalaw.com

Christopher K. DeScherer
Southern Environmental Law Center
P. O. Box 609
Charleston, SC 29402
cdescherer@selcsc.org

J. Blanding Holman, IV
Southern Environmental Law Center
38 Broad Street, Suite 200
Charleston, SC 29401
bholman@selcnc.org


Timothy Monahan
Monahan & Moses, LLC
13-B W. Washington Street
Greenville, SC 29601
Tim.monahan@momolaw.com

Sarah Catherine Rispin
Southern Environmental Law Center
201 West Main Street
Charlottesville, VA 22902
srispin@selcva.org

Thomas Moses
Monahan & Moses, LLC
13-B W. Washington Street
Greenville, SC 29601
tom.moses@momolaw.com

Michael Lavanga
Brickfield, Burchette & Stone, P.C.
1025 Thomas Jefferson Street, N.W.
8th Floor, West Tower
Washington, DC 20037-2474
mkl@bbrslaw.com

This 9th day of April, 2009.



Len S. Anthony
General Counsel